

Public Hearing of the U.S. Trade Deficit Review Commission

February 24, 2000

TESTIMONY OF SENATOR CHUCK HAGEL

Chairman

Subcommittee on International Economic Policy, Export and Trade Promotion

Senate Foreign Relations Committee

I would like to thank the Commission for inviting me here today to give my views on the causes and consequences of the trade deficit, and solutions for dealing with it. The **record-**breaking trade deficit of 1999 is both a reflection of our country's economic strength, and a cause for worry in the long-term, and I appreciate the opportunity to express my views on it.

Last year's trade deficit of \$271 billion is a clear indication of the imbalance between the U.S. economy and the other economies of the world. The U.S. has experienced a remarkable technological boom over the last few years, which has produced a sustained streak of incredible productivity, resulting in an incredibly high rate of return on our equipment and investments. This boom has given us the buying power to import more and more goods. Our interest rates, productivity, rate of return and stable investment environment have been so attractive to foreign capital that we have seen a huge influx of foreign investment in U.S. assets over the last few years. These foreign investments have helped finance even greater imports of foreign goods...leading to higher trade deficits.

As Alan Greenspan has said, this is a relatively recent phenomenon that began in the post-World War II years. Before the war, the rest of the world's economic growth was much higher and faster than the U.S. But in the post-war period, American economic growth has consistently outstripped most of the rest of the world. We have had a trade deficit each year for the past 25 years. What does this mean for our long-term economic prospects?

As we know, the rise in the trade deficit is caused by a combination of strong demand from U.S. consumers and businesses for imports, weak economies abroad, and large sums of capital flowing into the U.S. economy. The rise in the deficit therefore reflects U.S. prosperity and attractive financial markets. This is a good thing in the short term.

However, we may find ourselves in trouble if we reach a point at which foreign claims on U.S. assets become so great that we have difficulty paying them off. This is all uncharted territory. No one really understands this. Right now, at \$271 billion, the trade deficit represents 3% of our GDP, one of the highest ratios ever. We are unsure as to exactly how high that ratio can go before it becomes a problem. I do not believe that a trade deficit of this size or larger can be continuously sustained without affecting our economy. In the future, the level of net claims on U.S. assets will continue to grow and it could become more and more difficult to service those claims - a major debt burden for America.

The quickest way of reducing the U.S. trade deficit is a recession - triggered either by increased interest rates, increased domestic protectionism, or both. But that is not an acceptable solution. The correct approach to dealing with these continued high trade deficits is to open new foreign markets for American goods and services.

The most important market we can open today is China. The United States Congress should vote to grant Permanent Normal Trade Relations to China. We should support China's move to become a member of the World Trade Organization (WTO). China supplies the U.S. with basic consumer goods like clothes, shoes and toys, but American businesses are unable to take advantage of Chinese market opportunities for our competitive goods. In 1999 we had a \$69 billion trade deficit in goods with China. As a member of the WTO China will be bound by the rules of an international trading regime. Meaning Chinese trade barriers coming down and American access to China's 1.2 billion population market. This would continue to propel free, fair and open trade between China, the U.S. and the rest of the world. Then we can begin to

redress our trade imbalance with China. But if we vote against Permanent Normal Trade Relations, we will in effect be ceding China market opportunities to our European and Asian competitors, because they will be able to take advantage of market access agreements and we will not.

We must open new markets for U.S. investment. Many criticize American companies for investing in foreign countries and thus “draining” jobs out of the U.S. However, American companies mostly invest overseas in order to be able to be competitive in overseas markets. According to the U.S. Department of Commerce’s research, in 1997, U.S. trade involving American parent companies, their foreign affiliates, or both accounted for 63% of all U.S. goods exported and for 40% of all U.S. imports of foreign goods. American parent companies tend to be a much more important source of supply to their affiliates than the affiliates are to their parents.

American firms must invest in overseas markets in order to anchor their export opportunities. They need a local presence in order to be competitive in those markets. And their success overseas translates into new and high-paying jobs here in the U.S.

Our businesses and farmers can offer very competitive products and services to the world. But our government must be engaged in helping open markets around the globe. The President and the Congress must make trade a priority. The President has lacked fast-track trade negotiating authority since 1994. Without this authority, which requires Congress to consider trade agreements within mandatory deadlines, with limited debate and with no amendments, the President is unable to effectively negotiate the market-opening international trade agreements our companies need.

Latin America offers a clear and present example of what this lack of Presidential negotiating power means for U.S. businesses competing overseas. As the *Wall Street Journal* pointed out on Tuesday, U.S. companies face fierce competition from Europeans in our own

back yard. The *Journal* quoted a report by the U.N. Economic Commission for Latin America and the Caribbean, which showed that in 1998, for the first time ever, the flow of investment from Europe into this region surpassed investment from the U.S.

But the U.S. is still the top investor in Mexico. And since the North America Free Trade Agreement (NAFTA) went into effect in January 1994, U.S. exports to Mexico have increased significantly. The peso crisis that hit Mexico just after NAFTA went into effect, weakened Mexico's ability to buy American exports. Despite the peso crisis early on, exports to Mexico increased from \$51 billion in 1994 to \$79 billion in 1998. By 1998 Mexico was the U.S.'s fastest-growing export market. That year Mexico surpassed Japan to become our second-largest foreign market for goods. As Trade Ambassador Barshefsky has noted, employment and wages have risen in all three NAFTA countries since the agreement went into effect. The benefits of free trade agreements are obvious.

We must also stop penalizing our American companies and farmers by inflicting unilateral economic sanctions on countries we don't like or don't agree with. In 1997, the President's Export Council listed 73 countries as being subject to some form of unilateral American sanction. These unilateral sanctions only achieve one thing - they deny American businesses and farmers export opportunities. The sanctioned countries still import goods and services from the rest of the world . . . but not American goods and services. The long-term effects are serious. When we eventually lift unilateral sanctions on these countries, our businesses and farmers find that they still have difficulty selling into these markets, because the foreign buyers see them as unreliable. The foreign buyers would prefer to buy from more reliable and competitive sources ... who have already captured the markets.

Lastly, we must keep our markets open. There are winners and losers in the marketplace. But without exposure to competition, our industries will be weak. Look at the U.S. automobile industry in the 1970s and 80s. Exposure to foreign competition forced the U.S. automobile industry to respond to market demands in order to survive and produce the kind of products the

consumer wanted.

When there is competition, resources get allocated to the most **efficient** industries and sectors - the law of comparative advantage. Our extremely low unemployment rate bears this out. Our trade deficit is the highest it has ever been, yet our unemployment rate is among the lowest it has ever been. So overall, the influx of foreign imports, and American investments in overseas markets have **not** conspired to increase unemployment in the U.S.

In conclusion, let me emphasize that continued large trade deficits are cause for concern in the long-term, but it is absolutely critical that we take the right approach to dealing with them. That means opening up new foreign markets for our competitive American goods and services, not shutting down our own markets, which only hurts us. Thank you.